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In the Supreme Court of the United States

October Term, 1964

No. 693

Federal Power Commission,

Petitioner,

vs.

M. H. Marr, Sun Oil Company, Continental Oil Company, General Crude Oil Company, Texas Eastern Transmission Corporation,

Respondents.

On Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

Motion of the People of the State of California and the Public Utilities Commission of the State of California for Leave to File Brief Amici Curiae in Support of Petitioner, and Brief Amici Curiae

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Motion of the People of the State of California and the Public Utilities Commission of the State of California for Leave to File Brief Amici Curiae in Support of Petitioner.

The People of the State of California and the Public Utilities Commission of the State of California (California), through their Attorney and Chief Counsel, pursuant to Rule 42 of the Revised Rules of the Supreme Court of the United States, respectfully move for leave to file, in the above-entitled case, their brief amici curiae, annexed hereto, which supports the position of the Federal Power Commission (Commission), petitioner herein. Pursuant to Rule 42, the consent to file brief amici curiae was requested of the parties. Petitioner has consented; all Respondents refused such consent.

The Attorney and Chief Counsel for the Public Utilities Commission of the State of California is charged with the duty and responsibility of representing and appearing for the People of the State of California and the Public Utilities Commission of said State in all matters concerned with public utility regulation (Section 307, California Public Utilities Code).

California's interest in this proceeding stems from its unique dependence upon natural gas as a fuel. Natural gas has changed from a waste byproduct of the oil industry to a unique fuel, now the sixth largest industry in the nation. Since California does not possess coal deposits sufficient for its energy requirements, it is compelled to rely upon natural gas. Almost seventy-five percent of the total gas consumed in California in 1963 was delivered from out of state. Ninety percent of all homes in California are heated by natural gas, and California industry depends upon natural gas as a fuel. In 1963 distributing utilities in California purchased almost one trillion cubic feet of natural gas from out-of-state pipeline companies subject to regulation by the Commission. The cost of this gas delivered at the State border was approximately $327,000,000, all of which was eventually borne by California consumers. California consumers have no realistic alternative for fuel.

Of vital concern to California is the issue in this case relating to the jurisdiction of the Commission over the sale by an independent producer to an interstate pipeline company of a leasehold interest in proven and developed natural gas reserves for use in supplying its interstate markets. As the largest natural gas consuming state in the nation, California's interest in an adequate supply of natural gas at just and reasonable prices will be permanently frustrated if regulation under the Natural Gas Act can be avoided by the lease sale-management agreement device utilized here. If this device to sell gas in interstate commerce is valid, the Natural Gas Act will be effectively repealed, insofar as producers

are concerned. *Phillips Petroleum Co. v. Wisconsin,* 347 U.S. 672 (1954) will be meaningless because the independent producers will have achieved the long sought "attractive gap" in the comprehensive system for regulating the transportation, production and sale of this unique natural resource.

Only recently California brought to this Court for review another device designed by producers to escape jurisdiction. See *California v. Lo-Vaca Gathering Co.,* 33 U.S.L. Week 4159 (U.S. Jan. 18, 1965).

In this case, petitioner primarily argues the scope of its jurisdiction under the Natural Gas Act. The brief which amici curiae are requesting permission to file contains an argument on the issue of jurisdiction over this sale as necessary to preserve the purpose of the Act by preventing the creation of an "attractive gap" of nonregulation. Secondly, an argument is presented on the issue of the applicability and relevance of *Federal Power Commission v. Panhandle Eastern Pipe Line Co.,* 337 U.S. 498 (1949), relied upon by the Court of Appeals.

California submits the annexed brief on behalf of California consumers and urges that this Court recognize and approve the exercise of jurisdiction by the Commission over lease-sale transactions designed to avoid regulation.

Respectfully submitted,

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Dated: March 9, 1965.

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Brief Amici Curiae on Behalf of the People of the State of California and the Public Utilities Commission of the State of California

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INTRODUCTORY STATEMENT

California adopts such portions of the brief of the Federal Power Commission, petitioner herein, setting forth the Opinions Below, the Jurisdiction, the Question Presented, the Statute Involved, and the Statement.

The interest of California in this cause is fully set forth in the motion preceding this brief.

SUMMARY OF ARGUMENT

The lease sale-management agreement is a direct sale of natural gas in interstate commerce in disguise, and is designed for no other purpose than to escape regulation.

The view that leases are an essential part of production is a broad, misleading concept, when compared to more perceptive decisions by this Court, and is incompatible with the necessity to regulate sales of natural gas in interstate commerce to protect the public interest.

In other fields of federal regulation this Court has refused to accept agreements or statutory interpretations which avoid jurisdiction. The Court will look to the substance of the parties' acts and not merely to the form they use.

ARGUMENT

The Purpose of the Lease Sale-Management Agreement Is the Creation of an Attractive Gap of Nonregulation, Contrary to and Restrictive of the Federal Regulatory Scheme Established Under the Natural Gas Act.

I. The Lease Sale-Management Agreement Is a Direct Sale of Natural Gas in Disguise.

In this case the Court is faced with another attempt by independent producers to escape the regulatory jurisdiction of the Federal Power Commission (Commission) under the Natural Gas Act.

The facts surrounding this transaction lead only to one conclusion—a direct sale of gas disguised as a conveyance of a developed gas leasehold. First, the producers and Texas Eastern Transmission Corporation (Texas Eastern) executed a direct sale of gas from the Rayne field at the extremely high price of 23.9 cents per Mcf. Second, this agreement was cancelled and certificate applications were withdrawn, because the "Catco" decision[1] set aside a similar sale at the lower price of 22.4 cents per

1. *Atlantic Refining Co. v. Public Service Commission,* 360 U.S. 378 (1959).

Mcf. Third, the producers and Texas Eastern agreed to a lease sale-management agreement where the producers sold their leasehold interest in a known quantity of gas between particular strata-levels, including the wells and other equipment, and, pursuant to the "management agreement", the producers continued to operate the gas producing properties.

While the price for the leasehold is represented as a lump sum, the Presiding Examiner concluded that the cost of the gas to Texas Eastern would be 24.34 cents per Mcf—almost a *half cent higher* than the price of the original direct sale agreement, and *5.8 cents per Mcf higher* than the "in line" price of 18.5 cents per Mcf for this field (R. 896-898).

It is now contended by the producers and Texas Eastern that this costlier sale of gas is incapable of being regulated by the Commission because it is the sale of a leasehold. Respondents argue that this sale is different from a direct sale at wellhead, which is concededly under Commission jurisdiction.

Two vital facts cry out for a holding that this alleged difference is undistinguishable from the direct sale at wellhead. First, by means of the contract-back feature the producers still produce. They bring the gas to the surface of the earth by operating the wells just as they would in a direct sale. Second, the only real difference, therefore, between the lease sale and a direct sale at wellhead is that the papers involved are entitled a "lease sale agreement" instead of a simple "sale". Everything else remains the same, except the higher cost which will be imposed on consumers of the gas. This subterfuge to avoid regulation must, therefore, be set aside.

II. The Panhandle Eastern Decision Must Yield to the More Important Purpose of Consumer Protection Under the Natural Gas Act.

The necessity for the Natural Gas Act has been defined by Congress:

> ". . . it is hereby declared that the business of transporting and selling natural gas for ultimate distribution to the public

is affected with a public interest, and that Federal regulation in matters relating to the transportation of natural gas and the sale thereof in interstate and foreign commerce is necessary in the public interest."[2]

This Court has stated that the Act's primary aim is the "protection of consumers against exploitation at the hands of the natural gas companies",[3] and that its purpose is to provide a "complete, permanent and effective bond of protection from excessive rates and charges."[4]

In order to give effect to consumer protection, this Court held, in the 1954 *Phillips* case,[5] that a sale of gas by an independent gas producer (i.e., one which neither transports gas in interstate commerce nor is affiliated with an interstate pipeline company) for resale in interstate commerce is subject to the Commission's jurisdiction. This jurisdiction specifically includes *"all wholesales of natural gas in interstate commerce, whether by a pipeline company or not and whether occurring before, during, or after transmission by an interstate pipeline company."*[6]

The broad jurisdictional grant of the *Phillips* case has been held to encompass sales made by a producer to an extraction plant that resells the processed residue gas,[7] sales made after the gas is produced, but before it is gathered by the purchaser-pipeline;[8] sales made to an extraction plant that processes the gas and

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2. 52 Stat. 821, 15 U.S.C. § 717a (1958).

3. *Federal Power Commission v. Hope Natural Gas Co.*, 320 U.S. 591, 610 (1944).

4. *Atlantic Refining Co. v. Public Service Commission*, 360 U.S. 378, 388 (1959).

5. *Phillips Petroleum Co. v. Wisconsin*, 347 U.S. 672 (1954).

6. *Phillips Petroleum Co. v. Wisconsin*, 347 U.S. 672, 682 (1954).

7. *Deep South Oil Co. v. Federal Power Commission*, 247 F.2d 882 (5th Cir. 1957). See Note, 63 Mich. L.R. 155 (1964).

8. *Saturn Oil & Gas Co. v. Federal Power Commission*, 250 F.2d 61, (10th Cir. 1957), cert. den. 355 U.S. 956.

returns it to the producer, who then sells it to an interstate pipeline company;[9] sales of gas not transmitted interstate until after being stored underground for some time at a place removed from the point of sale;[10] and gas sold in the wellhead before reaching the final regulating valve controlled by the buyer.[11]

Moreover, this Court has said during this term, in *California v. Lo-Vaca Gathering Co.*, 33 U.S.L. Week 4159 (U.S. Jan. 18, 1965), that "if suppliers of gas and a pipeline were free to allocate by contract gas from a particular source to a particular use, havoc would be raised with the federal regulatory scheme." The *Lo-Vaca* case raised the same public policy question as raised now, namely, may a pipeline company and a supplier immunize gas from the reach of federal regulation by the words used to characterize the transfer of gas? In *Lo-Vaca* the contracting parties attempted to avoid jurisdiction by designating gas as "intrastate gas". In the case at bar the respondents designate the sale of gas as a sale of a leasehold. The Court dealt with such attempts by saying:

> "Attempts have been made by one convention or another to convert a local transaction into one of interstate commerce (Sprout v. South Bend, 277 U.S. 163; Superior Oil Co. v. Mississippi, 280 U.S. 390) or to make a segment of interstate commerce appear to be only intrastate. Baltimore & Ohio R. Co. v. Settle, 260 U.S. 166. But those attempts have failed. *Similarly, we conclude that when it comes to the question, what gas is for 'resale', the present contracts should not be able to change the jurisdictional result.*" (33 U.S.L. Week 4160; emphasis added.)

9. *Argo Oil Corp.*, 15 F.P.C. 601 (1955). See Note, 63 Mich. L.R. 155 (1964).

10. *Continental Oil Co. v. Federal Power Commission*, 247 F.2d 904 (5th Cir. 1957). See Note, 63 Mich. L.R. 155 (1964).

11. *Continental Oil Co. v. Federal Power Commission*, 266 F.2d 208 (5th Cir. 1959), cert. den., 361 U.S. 827. See Note, 63 Mich. L.R. 155 (1964).

The Court of Appeals has concluded that a sale of a leasehold in a developed reserve of gas is different, and is entitled to non-regulation on the theory that any transaction involving a leasehold qualifies under the "production or gathering" exemption contained in Section 1(b) of the Act.[12] The only authority cited for this conclusion is a broad statement in *Federal Power Commission v. Panhandle Eastern Pipe Line Co.*, 337 U.S. 498 (1949), a case pre-dating the *Phillips* decision, and not involving a developed reserve of gas or a sale in interstate commerce. In that case, the Court said: "Of course, leases are an essential part of production."[13] In reaching its decision, the Court of Appeals primarily relies upon this broad statement.

But surely this language applies at most only to sales of leases where the purchaser pays a lump sum price for the leasehold and where he takes on the responsibilities of exploratory drilling, development drilling, and control and management of the wells. If the sale of a gas lease coupled with "management agreements" contracting back normal production operations to the seller, is exempted from Commission regulatory authority, the result can only be "havoc with the regulatory scheme." The "attractive gap" in regulation will be achieved.[14] If a sale of a lease under the facts present here is held to be an effective device to avoid regulation in the public interest, then the *Panhandle Eastern* decision

12. 52 Stat. 821, 15 U.S.C. § 717b (1958).

13. *Federal Power Commission v. Panhandle Eastern Pipe Line Co.*, 337 U.S. 498, 505 (1949).

14. See *Federal Power Commission v. Transcontinental Gas Pipe Line Corp.*, 365 U.S. 1 (1961); in which the Court stated: "Congress did not desire an 'attractive gap' in its regulatory scheme; rather Congress intended to impose a comprehensive regulatory system on the transportation, production, and sale of this valuable natural resource." 365 U.S. at 28. See also *Panhandle Eastern Pipe Line Co. v. Public Service Commission of Indiana*, 332 U.S. 507, 524 (1947); and *California v. Lo-Vaca Gathering Co.*, 33 U.S.L. Week 4159, 4160 (U.S. Jan. 18, 1965).

does "go far toward scuttling the Natural Gas Act."[15] Production of gas is the bringing of the gas to the earth's surface and not the legal form used to transfer gas to pipeline companies. If *Panhandle Eastern* means that the regulated sale of gas in interstate commerce can become unregulated by merely selling the leasehold rights (i.e., the gas), California submits it is wrong and must be overruled to preserve the larger, more important consumer protection purpose of the Act.

In our view, the issue is not whether a "lease" is essential to production, which appears to have been the concern of the Court in *Panhandle Eastern.* Rather, the question is whether a transfer of a gas lease is tantamount to a sale of gas for resale in interstate commerce and thus within the jurisdiction of the Commission. The Commission does not seek here to regulate the activity of producing gas. It seeks to regulate a transfer of gas by an independent producer to an interstate pipeline for resale in interstate commerce and such a *transfer,* whether by conveyance of the gas or by purchase agreement, is no less a transfer, no less a sale which the Commission is obligated to regulate under the terms of Section 1(b) of the Act.

Finally, in decisions prior to *Panhandle Eastern,* this Court had indicated that the production and gathering exemption in Section 1(b) relates only to control over the *activities* involved. *Colorado Interstate Gas Co. v. Federal Power Commission,* 324 U.S. 581, 603 (1945); *Interstate Natural Gas Co. v. Federal Power Commission,* 331 U.S. 682, 690 (1947).

In the *Colorado Interstate* case, this Court was faced with the question whether this exemption prevented the Commission from reflecting production and gathering facilities of a natural gas pipeline company in the rate base for rate making purposes. In

15. Dissenting opinion, *Federal Power Commission v. Panhandle Eastern Pipe Line Co.,* 337 U.S. 498, 516 (1949).

holding that such reflection was permitted, the scope of the exemption was defined as follows:

> "That does not mean that the part of § 1(b) which provides that the Act shall not apply 'to the production or gathering of natural gas' is given no meaning. Certainly that provision precludes the Commission from *any control over the activity of producing or gathering natural gas. For example, it makes plain that the Commission has no control over the drilling and spacing of wells and the like.* (324 U.S. 581, 602-3; Emphasis added.)

It is submitted that this interpretation of the exemption is more perceptive than that in *Panhandle Eastern.*

III. In Other Areas of Federal Regulation This Court Has Refused to Countenance Agreements or Statutory Constructions Which Avoid Regulation.

Respondents' obvious attempt to seize upon the broad statement in the *Panhandle Eastern* case in order to achieve nonregulation is nothing new to this Court. In other fields of regulation there have been similar attempts. However, this Court has made clear that what counts in such cases is what the parties actually do and not the words they use.

In the antitrust field, retail price maintenance agreements are unlawful combinations to suppress competition. *Dr. Miles Medical Co. v. Park & Sons Co.,* 220 U.S. 373 (1911). But this Court has said that judicial inquiry in such cases does not stop with a search of the record for evidence of purely contractual arrangements. Thus, is it unlawful for a manufacturer to secure adherence to his suggested prices by means which go beyond his mere declination to sell to a customer who will not observe his announced policy. *United States v. Parke-Davis & Co.,* 362 U.S. 29 (1960). Actions speak louder than words.

Similarly, in securities regulation under the Investment Advisers Act of 1940, it has been held that the statutory proscrip-

tion of "any practice which operates as a fraud or deceit" does not require establishing the elements of technical common law fraud, particularly proof of intent to injure and actual damage. Rather, the statute intended a "broad remedial construction" which requires disclosure of a personal interest in recommended securities. *Securities and Exchange Commission v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180 (1963).

And during this term, under the National Labor Relations Act, this Court has held that an employer cannot avoid the duty of collective bargaining with the union concerned by "contracting out" to an independent contractor the work of the union employees under similar working conditions. *Fibreboard Corporation v. National Labor Relations Board*, 379 U.S. 203 (1964).

These cases illustrate that the purpose of regulatory legislation cannot be avoided by technical arrangements—rather, the Court will look through such arrangements to the result reached. California urges that this case requires the same penetrating analysis.

If producers and pipelines are to be permitted to exclude a sale of natural gas for resale in interstate commerce from the regulatory jurisdiction of the Commission by labeling the transfer a "lease sale", form will have triumphed over substance and consumer protection will have been sacrificed in the name of the art of conveyancing. This Court has indicated time and again in its decisions involving the jurisdiction of the Commission under the Natural Gas Act that the purpose of that Act is to provide a comprehensive scheme of regulation. *Panhandle Eastern Pipe Line Co. v. Public Service Commission of Indiana*, 332 U.S. 507, 520 (1947); *Federal Power Commission v. Transcontinental Gas Pipe Line Corp.*, 365 U.S. 1, 28 (1961); *California v. Lo-Vaca Gathering Co.*, 33 U.S.L. Week 4159, 4160 (U.S. Jan. 18, 1965). Respondents' device, which is designed to find an "attractive gap" in that scheme, cannot be upheld.

CONCLUSION

For the foregoing reasons, California submits that the judgment of the Court of Appeals should be reversed.

Respectfully submitted,

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